

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROBERT L. COHEN AND JOYCE A. COHEN	:	DETERMINATION
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Years 1985 and 1986.	:	

Petitioners, Robert L. Cohen and Joyce A. Cohen, 5243 Beechnut Street, Houston, Texas 77096, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1985 and 1986 (File No. 807006).

Petitioners and the Division of Taxation, by William F. Collins, Esq. (Arnold M. Glass, Esq., of counsel) executed a consent to have the controversy determined on submission, without hearing, with all briefs and evidence to be submitted by April 19, 1991. Upon review of the complete record, Jean Corigliano, Administrative Law Judge, renders the following determination.

ISSUE

Whether that portion of the petition which challenges a notice of deficiency for 1986 should be dismissed as untimely.

FINDINGS OF FACT

Petitioners, Robert L. Cohen and Joyce A. Cohen, filed 1985 and 1986 New York State resident income tax returns under the status married filing separately on one return.¹

On his 1985 return, petitioner subtracted a farm loss of \$32,017.00 and an investment tax credit of \$1,606.00, based upon an investment in an entity identified as G & B Nursery Farm. He also claimed business losses of \$3,403.00 in connection with a business identified on an attached schedule C as Robert L. Cohen, Public Accountant. These losses were calculated by subtracting unreimbursed employee business expenses, "in connection with salaried position as senior V.P.", of \$4,003.00 from gross income of \$600.00. There is no information on the schedule C to indicate whether the income and expenses flowed from the same business. Petitioner itemized his New York deductions, and he included in those deductions interest payments of \$10,891.00.

On his 1986 return, petitioner reported a business loss of \$6,925.00 (a schedule C was not attached to the return offered in evidence), and he included in his calculation of itemized deductions interest payments of \$15,741.00. A wage and tax statement attached to his 1986 return shows wages, tips and other compensation of \$77,101.49 from L.R. Rothschild, Unterberg and Towbin of New York City.

In August of 1988, the Division of Taxation ("Division") began an audit of petitioner's 1985 and 1986 returns. A letter was sent to petitioner scheduling an audit in the offices of the Division on September 20, 1988 (this letter was not placed in evidence, and so its precise contents are unknown).

On September 19, 1988, petitioner telephoned the Division and spoke with the auditor assigned to this audit, Felipe Rivera. Petitioner stated that he was now living in Texas and

¹Petitioner Joyce Cohen is included in these proceedings only by virtue of having filed a joint return with her husband, Robert Cohen. Therefore, this determination is restricted to findings of fact with regard to Robert L. Cohen, and all references to petitioner from here on should be understood to apply to Mr. Cohen unless specifically noted otherwise.

provided Mr. Rivera with his new address and telephone number. There is some dispute between Mr. Rivera and petitioner with regard to agreements made by them in this telephone conversation. Petitioner's understanding of the conversation is set forth in a letter to Mr. Rivera dated September 19, 1988. In that letter, he objected to the audit on the ground that his 1981 tax return had been audited. According to petitioner, that audit resulted in substantiation of the 1981 income tax return as filed, except that an additional refund was determined on the basis of additional unclaimed business expenses. Petitioner stated his belief that auditing three out of six tax returns amounted to unwarranted harassment. As the only category of expense which was not claimed in all three years was the farm loss and related investment tax credit, he offered to provide information on these items only. He also made the following statements:

"I have contacted the administrative group for the 'G & B Nursery Farm 1985.' They told me that I should ask you to wait for data since they are presently in the midst of a Federal audit of the nursery. When the audit is completed the state will be notified regarding any changes."

Petitioner provided Mr. Rivera with the telephone number of the Farm's accountant so that he could verify that information if he wished to.

A letter dated September 21, 1988 from Mr. Rivera to petitioner evidences Mr. Rivera's understanding of his telephone conversation with petitioner. The body of the letter states:

"Pursuant to your request, the audit of your income tax returns for the years 1985 and 1986 may be conducted through the mail.

For that purpose, please remit to us evidence that substantiates the following items checked in our letter of August 18.

Interest Expense
Farm Loss
Investment Credit
Schedule C Expenses

As indicated in said letter, the evidence may be in the form of receipts, cancelled checks, records, or other documents. We will review them and give you credit for whatever amount you substantiate.

Please also send us copies of the federal income tax returns for said years.

The documentation must be received in this office by October 20, 1988.

Thank you for your cooperation in this matter."

Petitioner responded somewhat angrily to Mr. Rivera's letter. By letter dated September 27, 1988, he denied agreeing to have the audit conducted by mail (since, in effect, he objected to the audit being conducted at all). He also stated that he had just moved to his new residence and had 20 cartons of papers and records to unpack in order to find the records for 1985 and 1986. Petitioner reasserted his willingness to provide information about the farm loss. Finally, the letter stated:

"I would suggest that you call me and establish a dialogue regarding this matter and what will be done on a mutual basis rather than the unilateral, arbitrary and unacceptable method you are now utilizing."

By letter dated September 29, 1988, Mr. Rivera advised petitioner that the previous audit of his 1981 return "has no bearing on the present years audit". He also asked petitioner to send a written statement from G & B Nursery Farm confirming the federal audit and providing the location of the farm. Petitioner responded to this letter with a letter dated October 18, 1988. In this letter, he objected to what he saw as Mr. Rivera's ignoring statements made in the earlier letter. Specifically, he objected to Mr. Rivera's failure to call him to discuss the audit procedure and to Mr. Rivera's failure to verify statements regarding the Federal audit by contacting the Farm's accountant (see Finding of Fact "5"). He once again asked that Mr. Rivera discuss the procedure for conducting the audit with him.

Mr. Rivera sent another letter to petitioner, dated November 2, 1988, in which he stated:

"In our letter of September 21, 1988 we informed you that the audit of your income tax returns for the year[s] 1985 and 1986 might be conducted through the mail. We requested that you submit by October 20th the evidence substantiating certain items. In addition, on September 29, 1988 we requested a specific document also pertinent to the audit.

To this date, however, you have failed to supply the documentation requested.

Since this is the fourth letter we have sent to you requesting substantiation, we must soon make a determination in this case. If the substantiation requested is not forthcoming, we will have to disallow the deductions you took on the items checked in our letter of August 18, 1988 and assess the corresponding tax liability."

Dissatisfied with his communications with Mr. Rivera, petitioner sent a letter to then Commissioner of Taxation and Finance, Roderick Chu. In that letter, he reiterated his objection to having both his 1985 and 1986 returns audited and requested that the audit encompass only

one of the two years. If this request was denied, he asked to be supplied with the reasons for its denial. Petitioner then asked to have more time to supply documents and records, since he was not fully unpacked from his move to Texas and had moved twice since filing his 1985 return. Statements made in petitioner's letter indicate that Mr. Rivera previously sent and asked him to execute a consent to extend the period of time for assessment of the 1985 tax year, with instructions to return the form within 10 days of its mailing to him (which was November 2, 1988 according to the letter). Petitioner pointed out that he did not receive the consent form until November 9, 1988 and, therefore, had almost no time to respond. His letter indicates that he interpreted Mr. Rivera's letter, coupled with the request that he execute the consent form, as a threat to issue an unwarranted assessment. Finally, petitioner requested that the matter be transferred "to Albany", apparently meaning to the Division's central offices in Albany.

Commissioner Chu referred petitioner's letter to John B. Langer, Deputy Commissioner for Operations. Commissioner Langer replied to petitioner by letter dated December 7, 1988. In that letter, he stated that petitioner's 1985 and 1986 returns were selected for audit "by a routine manual screening process" and stated that it is a common practice for the Division to audit several years at the same time "for cost effectiveness to the state as well as the taxpayer." Commissioner Langer stated that additional time to gather and provide documents would be granted to petitioner, if he signed and returned the consent form sent to him on November 2, 1988. The letter directed petitioner to send the consent form directly to Commissioner Langer.

On December 23, 1988, the Division issued to petitioner two statements of audit changes for the years 1985 and 1986, respectively. The statement for 1985 disallowed petitioner's claimed business losses, farm losses and deductions for interest expenses and asserted additional tax due for 1985 of \$6,005.44, plus penalties and interest. In a section entitled "Remarks", the following explanation appears: "Since you failed to supply the substantiation requested, the investment credit is disallowed". The statement for 1986 disallowed petitioner's claimed business losses and deductions for interest expenses and asserted additional tax due of \$4,064.38 plus penalty and interest. There is no explanation on

this statement. Each statement includes a section showing that it was issued from the Maiden Lane office of the Division, which is in New York City.

Apparently, petitioner had not received the statements of audit changes when he replied to Commissioner Langer's letter of December 7, 1988, for he makes no mention of them in his own letter of December 31, 1988. In that letter petitioner expressed a great deal of dissatisfaction with the Division's audit procedures in general and Commissioner Langer's letter in particular. One paragraph is adequate to convey the tone of petitioner's letter and his most repeated complaint about the audit.

"It is clear that I, as a citizen, misread the nature of your mandate. I had thought it was 'compliance' of the taxpayers--not one of revenue raising as a prime directive. Since most taxpayers tax lines are patterned--containing similar income and deductions from year to year--your 'cost effective' 2 year at a time screening process guarantees the audit group the ability to harass taxpayers with a continuous audit of 100% of the returns filed. Further, the Federal IRS requests that if a taxpayer has been audited previously, for the same deduction claimed for the year under review, that you bring that matter to the attention of the service. Mr. Rivera and your letter reiterate that previous audits have no bearing on the current audits--leaving the State Dept of Taxation in the position to harass as well as abuse the taxpayer."

In this letter, petitioner offered to provide the Division with a "restricted" extension of time to assess tax for 1985, meaning an extension that would apply only to the audit of the farm loss and associated investment tax credit. Since the only substantial difference between his 1981 income tax return (audited by the Division) and his 1985 and 1986 returns was the farm related items claimed in 1985, petitioner believed that auditing other items was unnecessary. Petitioner made several other points in this letter. Most notably, he requested that the Division "rescind the threat" to disallow all deductions if he did not sign the consent form sent to him by Mr. Rivera and again requested that the Division select either 1985 or 1986 for audit. In this letter, petitioner also stated that he had finally "found" his 1985 return and expected to be able to send the Division documentation supporting his deductions and expenses by February. This, his letter states, would include Federal tax schedules related to G & B Nursery Farm which were originally prepared by the Farm's accountant.

By January 11, 1989, petitioner was in receipt of the statements of audit changes. In his

letter to Commissioner Langer of this date, petitioner stated that he did not accept the findings shown in the statements and that he would not communicate further with Mr. Rivera. He again requested that the audit be extended while he continued to gather information.

Petitioner forwarded to Commissioner Langer, with a cover letter dated January 30, 1989, the following documentation applicable to 1985: federal schedules F, 4562, and 3468 (regarding the farm loss and investment tax credit); bank and other creditor statements establishing payments of interest expenses; and invoices, canceled checks and worksheets relating to business expenses. He advised Commissioner Langer that he expected to be able to submit information with regard to the 1986 tax year by February 16, 1989. His letter states that he was at that time still awaiting a reply to his letters of December 31, 1988 and January 11, 1989.

Without replying to petitioner's letters, the Division issued a notice of deficiency for the 1986 tax year, dated February 10, 1989. It would appear that several of the letters exchanged between Commissioner Langer and petitioner after this date crossed in the mail.

Upon receipt of the notice of deficiency for 1986, petitioner wrote to Commissioner Langer by letter dated March 3, 1989. In this letter, petitioner protested the issuance of the notice of deficiency for 1986. He pointed out that the statute of limitations for assessment of 1986 did not expire until April 1990 and, therefore, that there was no necessity to issue the notice before giving petitioner an opportunity to submit substantiation of the items claimed. He reminded Commissioner Langer that in one of petitioner's previous letters he had stated that he would "be finished with 1986 data by about February 16". Petitioner strongly suggested that the Division's issuance of the 1986 notice of deficiency was precipitous and motivated by the Division's desire to issue an assessment before petitioner had an opportunity to submit substantiation of his 1986 expenses and deductions. Petitioner enclosed various records and documents to substantiate his 1986 return with this letter. The letter goes on to state, in part:

"I obviously do not agree with what your people have done and once again I ask that you rescind their actions.... Please advise as soon as possible so that I can determine whether it is necessary for me to secure and file a petition."

By letter dated February 22, 1989, Commissioner Langer responded to petitioner's letters of December 31, 1988, January 4, 1989 and January 11, 1989. This letter indicates that by this time Commissioner Langer had also received the letter of January 30, 1989, with its submissions. Replying directly to one of petitioner's major concerns, namely repetitious audits, Commissioner Langer stated:

"In your situation, your 1985 and 1986 New York State tax returns were selected for audit. This is four tax years after your 1981 audit. Additionally, new issues arose from your previous audit; namely the investment tax credit and farm loss."

Commissioner Langer also explained that Mr. Rivera's request for an extension of time for assessment of the 1985 tax year, concededly made well before the time period for assessment was due to expire, was necessitated by changes in the Division's automated accounting system.

The remainder of Commissioner Langer's letter states:

"By the time you receive this letter you will likely have received a Notice of Deficiency setting forth the amounts due shown on the Statement of Audit changes; therefore, the waiver originally requested by Mr. Rivera will no longer be of necessity.² We have taken the steps necessary to stop the maturing of this Notice to the collection stage pending adjustments to the audit findings when substantiation is submitted.

With respect to your 'restrictive extension', we do not require an extension for any items that are under Federal audit because you are required to notify New York State of Federal audit changes within ninety days of the final determination. The extension we previously requested would have covered all other issues raised on audit.

I am sorry that you viewed Mr. Rivera's letter of November 2, 1988 as a threat. I can assure you, it was merely his intention to inform you of the consequences of not responding by either substantiation of the items requested or signing of the waiver to extend the statute.

In view of the fact that your audit will be completed through correspondence, we are granting your request for transfer of your case to Albany. You will be contacted in the near future by a Central office tax technician who will be assigned to your case. In the meantime, if you have any questions regarding your audit, you may contact Howard Parsons, Tax Audit Administrator.... We have received the material you sent on January 30, 1989 and February 6, 1989 will forward it [sic] along with your case file to Mr. Parsons for reassignment.

This statement indicates that Commissioner Langer was referring to the notice for 1985, although it was the notice for 1986 that was actually issued.

We are sorry for any misunderstanding or inconvenience caused you. I'm sure this matter can be resolved with mutual cooperation." (Emphasis added.)

The second notice of deficiency, for the year 1985, was issued to petitioner on March 16, 1989, after his receipt of Commissioner Langer's letter of February 22, 1989. He replied to the notice with a letter to Commissioner Langer dated March 20, 1989. In it, petitioner complained that the Division had adequate time to review the documents submitted in January 1989 but issued the notice, disallowing all expenses and deductions for 1985, without discussing the adequacy of the submitted documents. He also contended that the issuance of the 1985 notice was inconsistent with the statements made in Commissioner Langer's letter of February 22. Petitioner's letter closes with the following statements:

"Please confirm to me in writing -- the status of this new deficiency (1985). Your letter of February 22, 1989 indicated:

1. you had transferred my support for years 1985 and 1986 to a Mr. Parsons.
2. I have not been contacted by any central office tax technician as indicated (at this time).
3. the 1986 Notice of Deficiency has been suspended pending adjustments to the notice because of audit findings based upon the substantiation that I had already submitted."

Petitioner filed a petition protesting the 1985 and 1986 notices of deficiency (assessment numbers A8812254351 and A8812254341, respectively) on June 5, 1989. By letter dated August 18, 1989, petitioner requested that the Supervising Administrative Law Judge issue a default order against the Division because of its failure to file an answer to the petition within 60 days of its filing.

Howard Parsons wrote a letter to petitioner, dated August 23, 1989, referencing assessment numbers A8812254351 and A8812254341 and the Division of Tax Appeals file number assigned to the petition (DTA No. 807006). Notations on the letter indicate that copies were sent to the Division's attorney. As pertinent here, Mr. Parsons' letter states:

"I asked Tax Technician II, Raymond Szmyr, of my staff to review your file and he advised me that he called you on August 17th and 18th to request additional information from you.

I gathered from after talking with him that since several issues were in dispute and since the Internal Revenue Service had not reached a conclusion in the audit of G&B Nursery, we will suspend action pending the final federal determination of the tax shelter.

When the federal has completed their audit, we will make our decision concerning the interest expense and self employment losses previously disallowed by the New York City District Office.

I apologize for the delay in our efforts to resolve this matter and regret the inconvenience it may have caused you.

I am enclosing copies of Form IT-115 which may be used in reporting the federal audit changes. Or if you do decide, you may send a copy of the final federal determination and we will make any applicable changes to the notice for 1985 which included this item.

If you have any questions, you may contact Mr. Szmyr at (518) 485-5906, who has been presently assigned to your case." (Emphasis added.)

By letter dated October 5, 1989, petitioner renewed his request for an order on default. The Division's attorney filed an affirmation in opposition to the motion and an answer to the petition on October 30, 1989. On November 9, 1989, the Supervising Administrative Law Judge issued an order denying petitioner's request for an order on default.

In its answer to the petition, the Division asserted that the petition "is untimely with respect to the Notice of Deficiency dated February 10, 1989, for 1986." Moreover, the Division requested that both notices of deficiency be sustained in full, with penalties and interest.

CONCLUSIONS OF LAW

A. In Matter of Eastern Tier Carrier Corporation (Tax Appeals Tribunal, December 6, 1990), the Tax Appeals Tribunal stressed "the necessity for clear, effective communication between the Division and taxpayers with regard to the position of the Division on specific tax issues concerning that taxpayer and the rights, duties and obligations of the taxpayer with regard to such issues." The case at hand illustrates the consequences of failed communications. Clearly, the fault is not one sided, but here it is petitioner who is asked to shoulder the entire burden of the labyrinthine correspondence generated by both parties, for what is at stake is petitioner's right to effectively challenge the assessments issued by the Division.

B. The primary issue to be addressed in this determination is whether the Division of Tax

Appeals has jurisdiction to consider petitioner's challenge to the notice of deficiency issued for 1986. It is not disputed that the petition, filed on June 5, 1989, was not filed within 90 days of the mailing of the notice of deficiency on February 10, 1989. The Division argues that, in accordance with sections 681(b) and 689(b) of the Tax Law, the notice of deficiency became an assessment after 90 days and cannot now be protested through the administrative adjudication process. Petitioner maintains that the notice of deficiency for 1986 was erroneously issued by the Division which intended to issue a notice for 1985, and he requests cancelation of both notices in the interests of fairness.

C. The 1986 notice of deficiency was issued after petitioner and the Division had exchanged a number of letters, but very little information. The correspondence shows that on January 30, 1989, petitioner sent Commissioner Langer documentation intended to substantiate claims made on his 1985 return. The Division then issued a notice of deficiency for 1986. After this notice was issued, Commissioner Langer wrote to petitioner and stated:

"We have taken the steps necessary to stop maturing of this Notice to the collection stage pending adjustments to the audit findings when substantiation is submitted".

Moreover, in his letter Commissioner Langer stated that the material submitted by petitioner would be forwarded to another Division employee and petitioner would be contacted "in the near future" by a tax technician who would complete the audit through correspondence with petitioner.

Petitioner understood Commissioner Langer's letter to mean that the notice of deficiency issued for 1986 was suspended pending a complete audit by the Division. Under the circumstances, this was a reasonable interpretation of Commissioner Langer's letter. When a second notice of deficiency was issued, this time for 1985, petitioner again wrote Commissioner Langer. In that letter, of March 20, 1989, he reiterated his understanding of statements made in the letter of February 22, most notably his belief that the notice of deficiency for 1986 had been suspended pending an audit of the materials he had submitted. He asked Commissioner Langer to respond to his concerns in writing. While petitioner still had approximately six weeks to file a petition to the notice of deficiency for 1986, it is apparent that he was still relying on

Commissioner Langer's letter of February 22 and awaiting contact from the Division as promised in that letter. The Division did not respond to petitioner's letter of March 20 or initiate an audit through correspondence and on June 5, 1989 petitioner filed a petition protesting both assessments. Petitioner attached a copy of Commissioner Langer's letter to the petition, stating:

"This [1986] notice is being held to prevent maturing pending receipt of 1986 substantiation -- which is Acknowledged in the next to the last par. of Mr. Langer's letter".

It is clear that petitioner actually relied on Commissioner Langer's letter and believed that the Division would review the materials he submitted for 1985 and 1986 and adjust the audit results accordingly. The correspondence between petitioner and the Division establishes that the Division advised petitioner that his tax liability would be adjusted based upon documentation submitted by him, regardless of any statements made on the notices of deficiency. Statements to this effect were made to petitioner by Commissioner Langer before the 90-day period expired and by Mr. Parsons after the petition was filed. The Division now takes the position that the 1986 notice of deficiency has matured into a fixed and final assessment. In view of the statements made to petitioner, to deny him the opportunity to challenge the 1986 notice of deficiency by submitting evidence to the Division of Tax Appeals would be manifestly unjust (see, Matter of Sheppard-Pollock v. Tully, 64 AD2d 296, 409 NYS2d 847; Matter of Eastern Tier Carrier Corp., supra). Therefore, I conclude that the Division is estopped from denying the timeliness of the petition with regard to the 1986 notice of deficiency.

D. Since this determination is limited to the issue of timeliness, it is not necessary to address petitioner's request that the notices of deficiency be canceled, essentially in the interests of fairness. However, petitioner's criticisms of the Division are so strong that I believe it is necessary to address at least some of his contentions.

As the Division's representative stated in his brief, the Division has the authority to examine a taxpayer's return to ascertain its correctness and to request substantiation of any items claimed

on the return (Tax Law § 697[b]). There is no evidence whatsoever that the Division selected petitioner's returns for audit in order to harass him. Moreover, the letters of Commissioner Langer and Mr. Parsons must be accepted as sincere expressions of the Division's willingness to review any documentation offered to them and to adjust the notices of deficiency accordingly. In short, I find no basis for petitioner's contention that the Division acted with malicious intent to harass him or deprive him of his rights.

On the other hand, the record shows that during a long period of written correspondence the Division did not convey to petitioner its reasons for disallowing deductions and expenses claimed on his returns or explain to him what documents would be necessary to substantiate his claims. While petitioner continually objected to the Division's audit and refused to grant the Division an extension of time in which to assess the 1985 tax year, he cooperated with the auditors by submitting documents to substantiate his claims. The Division's reasons for allowing or disallowing certain of those claims were first conveyed to petitioner in the Division's brief, filed in this matter in March 1991. A taxpayer cannot be expected to carry his burden of proof if the Division does not clearly state its reasons for making adjustments to the taxpayer's filed returns (cf., Matter of Vincent Basileo, Tax Appeals Tribunal, May 9, 1991).

E. The petition of Robert L. and Joyce A. Cohen is granted to the extent that the matter is remanded to the Division of Tax Appeals for further proceedings consistent with this determination.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE